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SUBJECT: ELECTRICITY SUBSIDIES EXTENDED FOR ONE MONTH

REF: A. SAN SALVADOR 1364
¶B. SAN SALVADOR 1257
¶C. SAN SALVADOR 1392

¶1. (SBU) SUMMARY. The GOES agreed on December 18 to pay electric companies $15.7 million (covering one month of electricity subsidies) in order to maintain subsidized electricity rates through January 11, 2009. Again, state-owned generation company (CEL) had to pay the subsidy. Energy and subsidy costs continued to rise in November despite falling oil prices. CEL raised its prices and production to compensate for the subsidy and other generators are still using expensive fuel purchased in July. Distribution companies have also run into problems securing the bonds required by government. END SUMMARY.

¶2. (U) On December 18, distribution companies signed an agreement with the GOES and CEL to keep subsidized electricity rates from December 12, 2008 to January 11, 2009. In exchange, CEL will issue $15.7 million in credits for December energy bills to cover a one-month subsidy payment. This follows a two-month agreement in November where CEL agreed to pay $31 million to maintain subsidized rates from October 12) December 11.

¶3. (U) Together, the two agreements cover only half of the $94 million in subsidies accumulated from April 12) October 11, 2008. In the current system, designed to stabilize electricity rates, the energy regulator conducts biannual electricity rate "resets" in April and October, when the GOES must either adjust electricity rates to reflect real energy costs from the preceding 6-month period or commit to a schedule of subsidy payments to maintain subsidized energy rates. Facing serious short-term liquidity problems (ref A), the GOES has steadfastly refused to adjust rates to reflect real energy costs as it struggles to arrange payments for two-month and one-month periods. (Note. Electric companies and the think tank FUSADES have said that roughly 80% of subsidy benefits go to 20% of the largest industrial and residential consumers. End Note.) The GOES still must pay $47 million to maintain subsidized electricity rates until April 12, 2009, when the next "reset" will be held.

¶4. (SBU) GOES officials have repeatedly claimed that the Central American Bank for Economic Integration (CABEI) would provide a $60 million loan to cover the outstanding subsidy debt. However, a CABEI representative recently told Econoff that loan discussions had not been concluded and no loan would be approved before January (ref A). Thus, the GOES has continued to press CEL to make subsidy payments despite CEL's repeated public statements that it does not have the funds to pay the subsidy. Industry sources report that CEL,s joint venture geothermal company LaGeo provided the most recent payment.

ENERGY COSTS STILL RISING AS OIL PRICES FALL

¶5. (U) During a December 4 meeting of AmCham,s Energy Committee, industry sources cited two main factors that caused average wholesale energy prices and subsidies to rise to their peak in November, even as oil prices declined. First, CEL has increased its wholesale energy costs and production levels in order to pay the subsidy. CEL,s wholesale costs rose 70% from $71 per megawatt hour (MWH) in November 2007 to $120/MWH a year later. Second, the two main thermal generators purchased 400,000 barrels of fuel oil for $110 per barrel in late July and they still need to recover costs for 120,000 remaining barrels.

¶6. (SBU) Company managers told Econoff they would begin reducing energy prices in December, before this expensive fuel is exhausted in January. They nevertheless projected the subsidy will rise from $94.6 million (April-October 2008) to $98.2 million during this six month period (October 2008) April 2009), due in part to increased, and more expensive, thermal generation during the current dry season.

REGULATOR TRIES TO LOCK IN SUBSIDIZED RATES

¶7. (SBU) Energy industry contacts reported that during a December 5 meeting, the energy regulator (SIGET) presented its annual adjustment of distribution charges that included language to lock in subsidized rates beginning on January, ¶2009. Those rates would have applied regardless of whether the GOES committed to pay the subsidies. However, the companies discovered the rather obvious ploy and objected to it at the meeting. SIGET acknowledged the "mistake" and later removed the rate freeze. Sources told Econoff that the companies were prepared to contest the decision in court, if SIGET followed through.

COMPANIES RENEGOTIATE BOND REQUIREMENT

¶8. (SBU) Distribution companies are negotiating with banks and the market operator (UT) to modify financial guarantee requirements for monthly power purchases after local banks raised fees and placed limits on bonds they will provide. The two main distribution companies, Del Sur and AES reported that annual bank fees for bond guarantees have risen from 0.125 to 2 percent for Del Sur and from 0.1 to 3 percent for AES. AES,s monthly bond requirements (based on average energy costs over the preceding six-month period) reportedly doubled in 2008 and they now exceed transaction limits for Salvadoran banks. The banks were also influenced by their increased liquidity needs in light of the uncertainty of the upcoming elections in January and March as well as rising concerns about the government's ability to make subsidy payments. While other distributors have been able to renew their bonds, U.S.-owned AES's bond requests have been refused by four banks and the company has not yet resolved the problem.

COMMENT

¶9. (SBU) The GOES has bought itself another month, but will be challenged to schedule remaining payments of $47 million needed to maintain subsidized rates through the March 2009 elections. A recently approved $500 million IDB loan (ref C) may temporarily alleviate GOES liquidity problems, but the challenge of financing subsidies will continue as the elections approach. Even if the GOES can maintain President Saca,s commitment to maintain the electricity subsidy until he leaves office, it will leave a financially strained electricity sector and unsustainable subsidy policies for a new president to address. Saca claims the subsidy is for the people, but 80% of it ends up going to (presumably) the wealthiest consumers, the largest industrial and residential users. Ironically, the subsidy may increase El Salvador,s energy costs relative to regional competitors, as CEL will

need to charge higher hydro-electric energy rates for some time to pay the subsidy bill.
GLAZER